Clark Capital MANAGEMENT GROUP

Navigator® Fixed Income

Jamie Mullen, Senior Portfolio Manager

Third Quarter 2017 — Portfolio Commentary

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Senior Portfolio Manager

As a Senior Portfolio Manager, Jamie manages the Taxable and Tax Free Fixed Income Strategies. He is a member of the Clark Capital Investment Committee. Jamie has over 30 years of experience with fixed income securities. He began in municipal credit research and worked in public finance before moving to a position in trading, where his experience included trading municipal bonds and employing fixed income futures and futures options. He has extensive experience in dealing with mutual funds, trust departments and money managers. He received his degree from St. Joseph's University. He joined Clark Capital in 2005.

"THE WAITING" IS THE HARDEST PART *Tom Petty*

The Beginning of QT

The October Federal Reserve meeting brought the official end of QE and the beginning of Quantitative Tapering (QT). The Federal Reserve announced that it will begin the process of normalizing its $4.5 trillion balance sheet. As expected, the Fed will begin the process in October and it will cap its roll off at $10 billion ($6 billion of Treasuries and $4 billion of mortgage backed securities) for the next three months.

Twelve of the sixteen FOMC participants think another hike this year would be appropriate. Judging by fed funds futures, the December 13th meeting would seem to be the most likely time for another 25 basis point increase.

Don't it feel like heaven right now?

The quarter closed with the Dow, The S&P 500 and the Russell 2000 all at new all-time highs. Volatility is subdued across all asset classes. High yield bonds continue to grind out positive returns in the quarter.

Don't it feel like something from a dream?

September 15th was the ninth anniversary of the Lehman Brothers collapse.

September 2008 saw ZIRP. During the height of the financial crisis the Fed lowered the overnight lending target to zero.

November 25th will be the ninth anniversary of the announcement of QE 1 by the Fed.

In another year, when the 10th anniversary rolls around, the 2008 performance numbers will fall off money managers' and mutual fund performance. The March 2009 S&P 500 low will be a plot on a chart. The Fed so far has navigated the path to financial stability. And the shock and awe of the financial panic will continue to fade as new spirits take control of the markets.

Learning to Fly

The Treasury yield made its second quarter low on September ninth at 2.04%. As we closed the quarter, Treasury yields rose for three straight weeks, breaking some technical resistance at 2.30%. It looks like a move to 2.60% is likely to happen in the fourth quarter. Three main factors contributed to the rise. The Fed confirmed its intention to raise rates again this year, most likely at the December meeting. The speculation about a new Fed chairman and the new name being thrown about is that of Kevin Warsh. And last, a new tax reform plan that looks more like a wish list but could greatly add to the federal deficit.

Past performance is not indicative of future results.

This is not a recommendation to buy or sell a particular security. Please see attached disclosures.

But I ain't got wings

Inflation has stubbornly stayed below the Fed's target of 2%. The Fed has appeared to come off that hard line as they look to continue to raise short term rates once more this year. The Fed believes that the persistent low inflation numbers are transitory. Please review my second quarter Commentary as it addresses the topic of "transitory" vs "transformational."

Eurozone 2-year yields are negative everywhere but Greece. 5-year yields are still negative in France, Germany, Netherlands, Sweden and Switzerland. Although the negative yields did not close the quarter on their lows, negative yields still create demand for short term corporate bonds and Treasuries by global investors.

Free Fallin'?

We need inflation to kick up and the eurozone to stop the persistent negative yields to see rates accelerate higher. That said, looking at the 2, 5 and 10-year charts, Treasury yields closed the quarter above their 30, 50 and 200 day moving average. 2-year yields closed at 1.48, the highest yield since October 2008. 5-year Treasuries look poised to hit 2% on their way to 2.20%. If 10-year yields clear 2.40%, the next stop appears to be the November 2015 and the March 2016 highs of 2.60%.

These moves are simply the natural ebb and flow of markets. Higher can be positive for investors' re-investment rates. Eventually the equity bull market will end, volatility will return and bonds will be a diversifier in balanced portfolios, as always.

Gonna leave this world for awhile

I've made a lot of references to the late Tom Petty's music in this piece. Tom Petty released his first album 41 years ago and 31 years ago I started in a muni bond firm. Believe it or not, both involve maverick life styles. A musician has an ear, important in putting music together. A trader's ear has to catch the sounds of the market. Whether it's losing money on Black Monday in 1987 *(Don't do me like that)* or the screeching halt to the credit markets in the financial crisis of 2008 *(You don't know how it feels)*, turning on the radio at the end of the day has always been my way to unwind and de-stress. Music can be soothing and an inspirational force in our lives and when one has a few heroes it helps. Thanks Tom Petty. R.I.P.

Navigator Taxable Bond Portfolio

Front end selling continued in the yield curve during the quarter. High yield continued to grind out positive returns.

With the front end of the yield curve yielding 1.5 to 2% in investment grade corporates, we like positioning the portfolio in a barbell strategy. We hold some callable bonds in the high yield space in an effort to increase income and yield. The holdings are generally BB credits with calls of 2017 to 2019 helping keep our duration on target of 4.5 to 5.5 years. Investment grade corporates that we held in the 7 to 9 year maturity range generally benefited from spreads contracting against similar duration Treasuries.

Navigator Tax-Free Portfolio

What started at the end of the second quarter continued on into the third quarter which was the re-investment of the June through August coupon interest, maturities and called bonds. This positive seasonality in munis continued even after Treasury bonds reached their yield low in September.

The first five years of the yield curve in California continued to trade in the 60 to 70% of Treasury range. To give you an idea, a 5-year California bond trading on August 1st with the 5-year Treasury bond at 1.80% would have a 1.17% yield trading at 65% of Treasuries. That just doesn't seem like a value to us. Seasonality will change again and we believe we will see better value in the fourth quarter.

Source: Bloomberg, Ned Davis Research

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The Bloomberg Barclays U.S. Government and Credit Bond Index measures the performance of U.S. dollar denominated U.S. Treasuries, government-related, and investment grade U.S. corporate securities that have a remaining maturity of greater than 1 year. In addition, the securities have $250 million or more of outstanding face value, and must be fixed rate and non-convertible.

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